VZCZCXYZ0015
RR RUEHWEB

DE RUEHEG #2167/01 1930921
ZNR UUUUU ZZH
R 120921Z JUL 07
FM AMEMBASSY CAIRO
TO RUEHC/SECSTATE WASHDC 6109
INFO RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOC/USDOC WASHDC 0296

UNCLAS CAIRO 002167

SIPDIS

SIPDIS
STATE FOR NEA/ELA, NEA/RA, EB/IDF
TREASURY FOR IA/MATHIASEN AND HIRSON
COMMERCE FOR 4520/ITA/ANESA/OBERG
E.O. 12958: N/A
TAGS: ECON EFIN EINV EG
SUBJECT: 2007/2008 BUDGET APPROVED

Summary

¶1. (U) The Egyptian budget covering fiscal year 2007/2008 (July 1, 2007-June 30, 2008) was recently approved and the preliminary results from the just-ended fiscal year were released as well. Revenue collection remained robust (although not as strong as last year) and growth of expenditures tapered off from last year, so a deficit reduction is expected. The new budget contains many of the same characteristics as budgets past, but some wrinkles as well. Although deficit reduction is a key element of the economic reform program, the government envisions an increase of expenditures in 2007/2008, so some recent progress on deficit reduction may be lost next year. End summary.

Reforms reaping some benefits

¶2. (U) Recently released budget documents indicate that the Finance Ministry is already beginning to celebrate additional revenues created from some of the recently enacted reforms: (i) wider tax base as a result of lower rates and increased compliance, (ii) tariff rate reductions leading to higher customs revenues, (iii) Treasury Single Account reform reportedly generating interest payment savings, (iv) interest payment savings from the restructuring of the relationship between the National Investment Bank and the Social Insurance Funds, (v) the stamp duty, and (vi) the reduction in energy subsidies.

¶3. (U) Actual revenue collection for the recently-ended fiscal year is expected at LE 172.1 billion ($30 billion), a 13.8 percent increase over last year. Expenses were LE 212.1 billion ($37.3 billion), a 2.1 percent increase over last year. A significant contributor to those increased revenues is estimated one-time inflows of LE 28.6 billion ($5 billion) from privatizations. The bulk of that comes from the third mobile license sale (LE 15 billion or $2.6 billion) and the Bank of Alexandria sale (LE 9 billion or $1.6 billion).

Subsidies are a mixed bag

¶4. (U) Subsidies have long been an important part of any Egyptian budget. Roughly 15 percent of the 2005/2006 budget (or six percent of GDP), for example, was dedicated to energy subsides (excluding electricity). To put that in perspective, the Egyptian Center for Economic Studies estimates that energy subsidies are twice the amount the government spends on defense and three to four times those spent on health. Until the 2005/2006 budget year, these subsidies were always implicit (i.e. not referred to in any budget document), but Parliament and international pressure helped encourage the government to reflect these figures.

¶5. (U) The new budget states a very welcome upfront goal of redistributing subsidies from wealthy to the lower-income classes.

Energy subsidies have quadrupled in the last three years as a result of steadily rising oil prices, even when taking into consideration a partial reduction in subsidies last year, and Egypt still has some of the highest energy subsidies as a percentage of GDP in the world. The new budget envisions energy subsidies dropping slightly from LE 40 billion to LE 37 billion (from $7 to $6.5 billion), while the overall subsidy bill will edge upwards from LE 54 billion to LE 58 billion (from $9.5 to $10 billion). Another improvement in this year's budget is that the electricity subsidies, which had remained implicit, are exposed as a line item (LE 2 billion or $352 million) for the first time.

What to do with the windfall?

¶6. (U) The Government is committed to reducing the budget deficit by 1 - 1.5 percent each year until reaching a goal of three percent in 2010/2011. Per the GOE figures, that yearly target was achieved in FY2006/2007, as the estimated overall budget deficit fell from 8.2 percent to 6.7 percent. Faced with the choice of using the windfalls to further reduce the deficit or to spend the windfalls, the government envisions more of the latter in 2007/2008, while stating its intention to still meet the 2011 deficit target. As a result, the overall deficit is expected to tick slightly upwards to 6.9 percent of GDP next fiscal year. Much of the windfall in 2006/2007 went to retirement of non-performing loans in the public banks (LE 9.2 billion or $1.6 billion). Other uses last year were for the railroad refurbishment and expansion of sewage treatment plants. The government has many social objectives it feels it must address so the 2007/2008 budget envisions uses for teachers salaries, housing, training, Upper Egypt, etc.

¶7. (U) Comment: Using the privatization receipts to clean up the non-performing loans at the state-owned banks will obviously improve the banks' bottom lines. However, the GOE still needs improve bank management and risk management tactics so that the build up of bad loans does not immediately repeat itself.

Transparency and budget process still needs help
-- ---

¶8. (U) Data accuracy and availability continues to be a problem in Egypt, although improvements certainly have been made in recent years, most notably with Egypt qualifying for the IMF's Special Data Dissemination Standards several years ago. In 2006, the Open Budget Institute gave Egypt a score of 18 (out of 100) on budget transparency. The U.S. continues to work with the Ministry of Finance to improve budget processes and transparency, but more work remains. The Egyptian budget is not programmatically driven, nor does it use results-based budgeting approaches. While the Parliament is increasingly interested in trying to debate the content of the budget, without aggregations by function, or analysis of previous years' results or failures, the Parliamentarians' job is made quite difficult. The Constitutional amendments approved earlier this year do give the Parliament more potential influence over the budget process. The amendments: allow Parliament to amend the Government's budget proposal, allow Parliament to move funds from one budget chapter to another, and provide Parliament with more time to evaluate the budget before the fiscal year starts.

Inflation vs. deficit reduction

¶9. (U) Despite the improvements in budget transparency, an analysis of the budget still shows many areas of wasteful and unproductive spending, and a lack of spending on development of human capital. Unless wasteful spending is addressed, it may be difficult for the GOE to make the needed investments in human capital and simultaneously stay on track to reduce the deficit by 1.5 percent each year. While the GOE expects several additional new revenue measures in the coming year (real estate tax and VAT, most notably), their revenue impact is also expected to be minimal, at least initially. Government spending is a large contributor to money growth, and is contributing to higher than anticipated inflation in
¶2007. It is precisely these fears of increased inflation which account for GOE hesitation in introducing the VAT and making further subsidy reductions. While these two steps would have a positive effect on the deficit, increased inflation exacerbate the already

skeptical attitude of much of the Egyptian population toward the benefits of the government's economic reforms.